



1942

General Business Conditions

THE war continues to tighten its grip upon every form of economic activity. Its enormous demands for materials, manpower and money are pressing harder on available resources, and the use of these resources is passing more and more under government control. Even manufacturers using non-critical materials, whose operations until recently were little hampered, are now meeting difficulty due to labor shortage or abnormal labor turnover.

For most of the war effort to date government regulation of the industries, apart from price control, has been for the purpose of hastening conversion, conserving critical materials, and securing priority for war work. Now it is concerned also with increasing the overall efficiency of the economic organization, and thus lifting the ultimate ceiling on production to the highest possible level. After providing for plants and equipment prodigally, they must be supplied with materials and labor, transportation, fuel and power, — all without impairing equally essential work elsewhere, and all in the proper places and proportions for a balanced output. This is a task of almost incomprehensible complexity, and one which will become both more pressing and more difficult as limits on productive capacity become more apparent. It involves breaking down bottlenecks, by increasing supplies of materials and labor and distributing them more effectively. The efficiency of the individual plants, and so of the whole effort, will depend greatly on how well this task is done.

New Patterns of Government Regulation

During the past month the spread of government controls has dominated the news, and the controls are assuming new patterns. Priorities in some critical materials have become ineffective because priority needs now exceed the total supply, and the priority regulations are in process of giving way to new methods of allocating the materials available. The regulation of inventories, which hitherto has been no more than an effort to keep critical materials

Economic Conditions Governmental Finance United States Securities

New York, November, 1942

moving, will soon be extended to limit manufacturers' and distributors' holdings of consumers' goods.

The principle of devoting entirely to war work the plants which are able to do that work best, and concentrating essential civilian production in those which could contribute least to the war effort — which in Great Britain is the general practice — is being applied more widely. Thus in the limitation of farm equipment production to 20 per cent of the 1940 output, announced October 20, the small manufacturers are allowed all of the market they can supply, while the large ones, who are vital in the war effort, will have only what is left.

Declarations by government officials leave no doubt that simplification and standardization of consumer goods, in the interest of more efficient production, will be carried further. Also, the effort to ease the demands on the railways and trucking companies by reducing cross-hauls of goods will be stepped up. In time of war a tightening up of the industrial organization through concentration and simplification undoubtedly is possible. This does not signify that the organization is normally "inefficient" in any practical sense, or that such measures are applicable under peacetime conditions. The difference is rather that in peacetime the industries set themselves up to supply goods and services which represent the free choice of consumers, while in wartime consumers' choice must be limited and in many areas suspended. When people can be compelled or induced through patriotic motives to restrict their choice it is obviously possible to concentrate on goods whose production and distribution require the least labor, material and transportation, and thus to have more available for the war effort.

Finally, new government measures to accomplish a more effective distribution of labor and reduce turnover are in the making. They are of uncertain scope, and if they go as far as some proposals they will require Congressional legislation. Jurisdiction over labor has already been assumed in some cases. Since early Sep-

tember workers in non-ferrous metal and lumber industries in twelve western states have been forbidden to change jobs without a "certificate of separation" from the U. S. Employment Service. For the purpose of preventing labor "pirating" and reducing abnormal turnover, hiring of workers at wage rates above those already established for the job is interpreted as a wage increase, and forbidden. An order is being prepared which will grant deferment from selective service to workers on dairy, livestock and poultry farms, as long as they remain in that work.

Extensions of Control

All these are extensions of the principle of telling the industries what they can make, merchants what they can buy, and people what they can do. In normal times the distribution of materials and labor is guided by changes in prices and wages, which induce goods and people to move where the returns are best. In the long run this accomplishes the most desirable and effective distribution possible, from the viewpoint of people's wants, for no industry is more essential than another except as people's wants make it so. But in war civilian wants must be subordinated. It is not in the public interest to allow non-essential industries to bid against those engaged in the war effort for materials and labor, for the latter must have precedence, and competitive demand for a restricted supply, which would force all prices and wages up, is the essence of inflation.

It is appropriate to add that in suppressing the influences which normally direct the economic organization, and taking over their functions, the Government assumes a stupendous responsibility, whose wise discharge requires the greatest ability in planning, organization and administration that the country possesses. Recent developments in the administrative agencies have been decidedly heartening. The clearing up of confusion as to the facts of the rubber situation by the Baruch Committee has been followed by forthright action by Mr. Jeffers, and despite the sacrifices entailed by gasoline rationing in areas where gasoline is plentiful, the feeling of the country is one of relief that clear decisions have been taken and more vigorous measures to keep tires on cars set under way. Where necessity is shown and effective leadership provided people willingly cooperate. A precedent has been set which should be applied to similar situations.

New Anti-Inflation Measures

The additional steps taken during the month to combat the inflationary menace further extend the area of government control. The

measures taken under the President's executive order of October 3 bring all salaries under regulation, with intent to freeze them except under certain specified conditions. Wage controls are strengthened, and many more foodstuffs have been placed under price ceilings. The new federal tax law will extend income taxes, including the Victory Tax, to twenty-five or thirty million persons who have never before paid them.

These are forward steps in the struggle against inflation, although whether they will win the battle remains to be demonstrated. The increasing estimates of the cost of the war, the declining production of civilian goods, and the swelling industrial payrolls and farm income, all give evidence that still more widespread taxes are needed; and uncertainty persists as to how much use will be made of the loopholes in the wage controls, under which increases for correction of inequalities and elimination of sub-standard wages can be made. Belief that rising price and wage trends in any event will be retarded, however, is justified. If the stabilization policy as a whole is rigorously enforced, minor adjustments are not inconsistent, and may add to the efficiency of the industrial system. There were sound reasons for the action of the War Labor Board granting increases to non-ferrous miners in the West, for their work is plainly as essential to the war effort as the higher-paid war work which was attracting them away from the mines. On the other hand, such exceptions cannot be so numerous as to become the rule.

The \$25,000 Salary Limit

The regulations limiting individual salaries to \$25,000, after federal income taxes and (in hardship cases) certain other allowances, actually have little relevance to the control of inflation, since there will be little, if any, further diversion of income into the Treasury through this measure, and any reduction of spending will be very small. First, the number of persons having salaries above \$25,000, after federal taxes at present rates, is only a minute fraction of the population. The \$25,000 net is equivalent to \$67,000 before taxes. Treasury officials are quoted as estimating the number to be affected at between 20,000 and 24,000. Second, while the amounts by which salaries are reduced will be added to the taxable income of the employing corporations, in some cases at least the gain will be taxed less than if the money had passed into the hands of the salary receiver. The chairman of the Senate Finance Committee, Senator George, has expressed the opinion that the Treasury would lose, rather than gain, in tax collections on this move.

Third, the practical objective of the measure so far as the great majority of high-salaried

executives are concerned, had already been attained through the tax laws. In the October issue of this Letter a chart was published which showed that even a \$100,000 income would yield a net of only about \$30,000 after federal and New York State income taxes. But the Treasury will now have the extra burden of administering a new and highly complex set of regulations which include so many provisions that the determination of the allowable gross salary will be virtually a separate computation in each individual case.

Effects of the measure will fall predominantly on a group of corporation executives who, perhaps more than any other group, are the key men of the war effort. This further difficult adjustment of personal affairs will in many cases interrupt vital war work.

The measure makes an unjust distinction between salaries of men who are working and incomes of those who live on inherited or accumulated wealth. It is inequitable in its treatment of men on salaries, as compared with those whose earnings are partnership returns, professional fees, agents' commissions or fees under certain types of contracts.

The most harmful feature of all is the principle which the measure establishes. In the effect on incentive and morale, there is a clear difference between taxing a person heavily and progressively on what he earns, and limiting his earning ability, not in accord with the position to which he has risen over the years, but by an arbitrary figure. And if one arbitrary figure can be enforced why not another, until all inducement for one man to work harder and make himself superior to another in ability and achievement is destroyed?

The American Federation of Labor is on record as opposing a similar proposal. Testifying before the Senate Committee on Finance on August 12, Raymond G. Cranch, economist of the Federation, made the following formal statement:

We, therefore, recommend that no such arbitrary ceiling as a flat \$25,000 be placed on individual incomes after taxes. There will, of course, be increasing taxation, in accordance with capacity to pay, but the nation would indeed be short-sighted to limit productivity of its businessmen by such an arbitrary and inflexible rule.

Manpower Problems

Brief reference has already been made to difficulties in maintaining the labor supply in some areas and industries. As war work and the armed forces expand, these difficulties will give increasing concern. Testimony as to conditions in cotton mills was given by Paul V. Halstead, Secretary-Treasurer of the Cotton Textile Institute, at a hearing of the Wage and Hour Division of the U. S. Department of Labor in New York last month. Mr. Halstead pointed out that machinery activity ceased to expand last May and has since declined slight-

ly. He said the average machinery operation is about 109 hours per week, compared with a potential of 144 hours with six-day three-shift operation. Granting that some mills, because of unbalanced conditions, cannot run much more than two shifts, he stated that in other mills which are balanced to full three-shift running the attainment of greater output is checked by need of additional workers.

Mr. Halstead said the cotton mills, exclusive of dyeing and finishing establishments, employ 520,000 workers compared with 409,000 in 1939. They are having great difficulty in keeping their labor force intact because of the demands of the armed forces, the attraction of higher pay in war industries and, he added, "a high ratio of absenteeism because of job security and high wages." The quit rate in cotton manufacturing in June, the latest month for which figures are available, rose to 6.1 per cent of the employees, which is equivalent to an annual labor turnover of almost 75 per cent. This showing could be duplicated elsewhere. It is occurring long before the demand for manpower in the armed forces and the industries will reach its maximum.

Although it is now indicated that no early "draft" of labor is intended, the extent and character of federal intervention in the direction of the labor supply will be a major issue during the next few months. It is important at the outset to establish principles and define the problem. One consideration is that the prospective labor supply cannot even be measured until the size of the armed forces is determined, with reference both to strategic needs and to the ability to equip the forces, transport them and supply them in the field. Secretary Stimson's estimate that the Army would require 7½ million men at the end of 1943 is the first clearing of the air in this respect; it disposes of extravagantly larger estimates, which were causing fear that the program would leave the armies and the labor force unbalanced in size. Once this figure is established other decisions become possible.

Another main consideration is that labor shortages in certain areas do not signify a general manpower shortage nor indicate that it is even imminent. Rather, the facts are to the contrary. The first fact is that unemployment is still marked in some areas. Recently the War Manpower Commission listed 97 such areas, of which New York City is one of the most important. The second fact is that the labor supply can be greatly expanded by drawing into it, from the homes and the schools, several millions of people not now engaged in gainful occupations. Nor has the diversion of manpower from civil occupation to war work gone as far as it will.

The Forty-Hour Week

Third, many industries are still working on the 40-hour week, some even less. The following table gives the average hours per week in manufacturing industries in August as reported by the U. S. Department of Labor, and it shows that although the durable goods industries, the equipment industries in particular, averaged above 45 hours, the non-durable goods plants as a whole averaged slightly less than 40. In Great Britain the Ministry of Labor ruled on May 20, 1942, that a plant in which the standard minimum working week is below 52 hours for industrial labor is not deemed to be utilizing its employees to full capacity; and the average work week is 55 to 60 hours.

Average Weekly Hours in Manufacturing Industries

Industry	Aug. 1942
All Manufacturing	42.8
Durable Goods	45.2
Non-durable Goods	39.9
Iron and steel and their products, not including machinery	42.8
Machinery, not including transportation equipment	47.8
Transportation equipment	46.5
Non-ferrous metals and their products	45.0
Lumber and allied products	41.6
Stone, clay and glass products	38.7
Textiles and their products	38.8
Wearing apparel	35.9
Leather and its manufactures	38.2
Food and kindred products	41.5
Tobacco manufactures	39.4
Paper and printing	39.4
Chemical, petroleum and coal products	41.2
Rubber products	42.2

Source: U. S. Department of Labor.

In the cotton mills, as described by Mr. Halstead above, the five-day 40-hour week for workers prevails. If they worked 48 hours, less labor would be employed in turning out the goods needed, and labor would be released for the war plants in the cotton manufacturing areas. The main obstacle to the longer work week, of course, is the requirement of the Wage and Hour Law that time and a half be paid for overtime.

The fourth fact is that utilization of the labor supply unquestionably can be improved. It is too much to hope that every worker can be located where he can be most productive, and stay there; but abnormal turnover, and the abnormal absenteeism of which Mr. Halstead spoke, are evidence of slack to be taken up. Not least of all, union rules and practices which have been built up to make work and create additional jobs continue in effect.

These facts, taken together, support the view that before taking a decision to draft workers, putting them into essential jobs and compelling them to stay there, improvement in employment conditions should be sought in other areas. All the history of free peoples shows that men and women so drafted could hardly

be expected to work as effectively as if they still exercised a measure of choice as to their occupation.

Farm Labor Shortages

Shortages of farm labor unquestionably are leading to an increasing movement of owners and operators away from the farms and to curtailment of programs for 1943 crops. The shortages are of two kinds, one of skilled labor that is needed on dairy, poultry farms, and the other the seasonal workers required for harvest. Selective service policies, as already noted, will hereafter take account of the need to keep skilled workers in their employment; and although in some places crops have gone unharvested this year many have been saved by community effort, which has included closing of schools and in some cases the shutdown of all other activities, while people cooperated to get in the harvest.

The error to be avoided in considering the farm labor problem is to think that a normal labor supply, either in quantity or quality, can be maintained by constantly raising wages, and that farm prices therefore should be advanced to permit wage increases. Such a policy would be inflationary in the extreme; if it were successful other essential work would be hampered; and it would ignore other possibilities of adding to the effectiveness of the labor supply available. In the general interest every such possibility needs to be explored.

Secretary Wickard has made public a six-point program: (1) to retain as many experienced managers as possible on the farms; (2) to provide organized transportation of workers from areas of relative surplus to areas of shortages; (3) to train inexperienced workers; (4) to use larger numbers of women and young people; (5) to do more recruiting for industries in the cities and less on the farms; (6) to utilize more fully the under-employed on the farms. In testimony before the Tolan Committee of the House of Representatives, investigating national defense migration, a representative of the Bureau of Agricultural Economics stated that if farms producing products worth less than \$1,500 annually were all as productive as those producing between \$1,500 and \$10,000, the total volume of agricultural production could be turned out on 2 million fewer farms. This is possibly the source of another statement by Secretary Wickard that there are about "2 million under-employed farm families."

Testifying before the same committee, Prof. John D. Black of Harvard University classified low income farmers by type. He placed particular emphasis on those "not working enough good land where they are to be anywhere near fully productive," and who are young enough and capable enough to move

into a better farming area or into another type of job. He said "we cannot afford under these circumstances to have a man puttering away with a mule and hand plow on a few acres of poor land." Specifically, Prof. Black was talking of policies of the Farm Security Administration, and criticising what he called a "tendency to want to hold onto its borrowers and keep them on the land even in very low income areas."

Plainly the country must look to a combination of government policy and community effort to sustain its agricultural production. This is true of the whole effort to increase the efficiency of the economic organization and lift the ultimate production ceiling. Everything that can be done by common effort and co-operation will ease the task of the overhead authority, and make the measures which the authority must impose less onerous and more effective.

Third Quarter Earnings

Reports for the third quarter and the first nine months issued to date by 225 industrial companies continue to show, in a majority of cases, an increase in sales but substantial decline in net income after taxes compared with the levels of a year ago, as was shown in reports for the first half year.

This group of companies, representative for the most part of the larger manufacturing organizations, and employing an aggregate capital and surplus of approximately \$9,893 millions at the beginning of this year, had net income

in the first nine months of 1942 of \$608 millions after taxes, which was 32 per cent below the earnings in the same period of 1941. The accompanying summary gives the comparative figures for the two years by major industrial groups.

The following separate figures by quarters show that the third quarter of 1942 was about 24 per cent higher than the preceding quarter, but 23 per cent lower than the third quarter of 1941:

Net Income After Taxes of 225 Leading Industrial Corporations (In Millions of Dollars)			
	1941	1942	% Change
First Quarter	\$309	\$203	- 34
Second Quarter	290	181	- 38
Third Quarter	292	224	- 23
Nine Months	891	608	- 32
Fourth Quarter	295

The improvement from the second to the third quarter this year may be due partly to adjustments in tax reserves, following the adoption of the 40 per cent normal and surtax rate instead of 45 per cent as in the House bill. An 80 per cent corporate tax ceiling, and late changes in several other provisions, afforded relief to many corporations subject to excess profits taxes at the new rate of 90 per cent and lowered their tax liability from that estimated earlier in the year. In such cases the previous over-accrual of tax reserves has permitted either an upward revision of income statements already issued for the half year, or else a corresponding reduction in the tax accrual charged against third quarter earnings.

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST NINE MONTHS

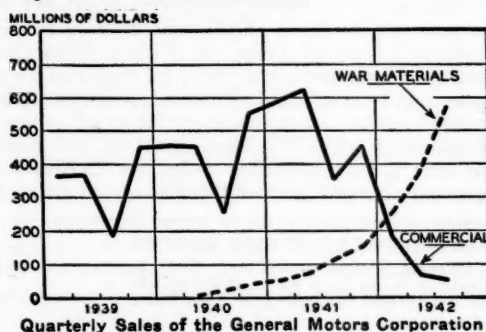
Net Income is Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. — Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.
(In Thousands of Dollars)

No.	Industrial Groups	Net Income Nine Months		Per Cent Change	Net Worth January 1		Annual Rate of Return %	
		1941	1942		1941	1942	1941	1942
7	Baking	\$ 12,908	\$13,406	+ 3.9	\$247,315	\$225,457	7.0	7.9
15	Other food and beverage	57,864	47,225	- 18.4	490,044	490,206	15.7	12.8
10	Textiles and apparel	8,443	7,138	- 15.5	100,804	106,585	11.2	8.9
8	Paper products	7,956	5,778	- 27.4	117,125	120,389	9.1	6.4
25	Chemicals, drugs, etc.	154,932	109,861	- 29.1	1,335,207	1,282,699	15.5	11.4
8	Petroleum products	52,672	37,233	- 29.3	900,566	895,495	7.8	5.5
6	Stone, clay and glass	16,864	7,183	- 57.4	176,060	176,184	12.8	5.4
24	Iron and steel	216,403	181,709	- 39.1	2,979,327	\$1,066,350	9.7	5.7
7	Building equipment	9,903	7,391	- 25.4	162,676	162,636	8.1	6.1
7	Electrical equipment	55,529	42,113	- 24.2	518,466	572,188	14.3	9.8
16	Machinery	23,072	19,448	- 15.7	185,791	204,782	16.6	12.7
5	Automobiles	163,445	86,435	- 47.1	1,114,278	1,143,467	19.6	10.1
10	Auto equipment	11,171	10,871	- 2.7	81,380	90,112	18.3	16.1
6	Railway equipment	12,844	8,340	- 35.1	128,018	139,596	13.4	8.0
18	Metal products—misc.	25,338	20,587	- 20.3	215,592	234,793	16.0	11.7
12	Misc. manufacturing	12,194	8,570	- 29.7	148,706	158,179	10.9	7.2
184	Total manufacturing	842,038	563,288	- 33.1	\$901,355	\$910,118	12.6	8.2
8	Coal mining	3,722*	4,672*	+ 25.5	183,702	188,442	2.7	3.3
6	Metal mining	15,465*	15,881*	+ 2.7	185,111	185,355	11.1	11.4
6	Mining, quarrying—misc.	14,959*	12,759*	- 14.7	114,027	119,536	17.5	14.2
12	Trade (whol. and retail)	11,088	7,628	- 31.2	186,926	190,766	7.9	5.3
9	Service and construction	3,664	4,245	+ 15.9	111,160	99,718	4.4	5.7
225	Total	\$890,936	\$608,473	- 31.7	\$9,682,281	\$9,892,935	12.3	8.2

*Before certain charges.

Analysis of the reports shows, however, that such adjustments were important only in the case of a limited number of concerns, and that for the group as a whole the major factors in the third quarter improvement appear to be the more complete conversion to war work, with consequent reduction of special charges connected with the changeover, and the gain in volume of sales of the armament producers.

The transformation of many great industries from peacetime to wartime production during the past two years may be illustrated by the accompanying chart tracing the quarterly sales of the General Motors Corporation, which makes available separate figures for its dollar sales of war materials. This company's sales of authorized commercial (non-military but essential) products have been cut to a low level, its 104 plants throughout the country are all operating on war production, and its sales of war materials have increased from approximately \$75 millions in the year 1940 and \$406 millions in the year 1941 to \$1,204 millions in the first nine months of 1942. This year the conversion was accompanied by a 48 per cent drop in net income after taxes.



The sweeping conversion of this organization is typical of that accomplished by Chrysler, Ford and practically the entire automobile and auto equipment industries, as well as numerous other industries now devoted almost 100 per cent, directly or indirectly, to war production.

Despite lower net income for the nine months reported by most companies, including those in relatively stable lines whose earnings reflected the heavy cut of the new taxes, about one out of every four, including numerous "marginal producers," moved upward against the general trend as a result of the tremendous expansion in output this year, and despite the continued rise in labor and other costs.

Sales figures given by 50 of the manufacturing companies aggregate \$5,701 millions for the nine months, compared with \$4,922 millions for the corresponding period of last year—an increase of 16 per cent.

The Rise in Taxes

Details of tax reserves given by the manufacturing companies that have reported thus far may be summarized as follows:

Taxes and Net Income of 135 Leading Manufacturing Companies (In Millions of Dollars)

	1941	1942	% Change
Net income before taxes.....	\$1,455	\$1,604	+10
Fed. inc. & excess profits taxes	791	1,160	+47
Net income after taxes	\$ 664	\$ 444	-33

It will be seen that such taxes took about 72 per cent of the net income before taxes this year, in contrast with 54 per cent last year.

Reducing these totals to terms of a simple average for the 135 large manufacturing companies in this group, the federal taxes upon income increased from \$5,900,000 per company for the first nine months of 1941 to \$8,600,000 this year, while net income after taxes declined from \$4,900,000 to \$3,300,000.

Taxes of these 135 companies alone for the first nine months of 1942 were almost identical with the sum-total of federal income taxes paid by all active corporations in the United States (some 456,000) in the full year 1929, when corporate net income was at peak.

Total taxes payable directly by the companies are considerably greater even than these figures indicate, because of the various state, local, social security and miscellaneous federal taxes. In addition, the corporate payments of wages and salaries to employees, interest to bondholders and dividends, if any, to shareholders are of course subject to the heavy federal individual income taxes, and in many cases to state income taxes, as well.

The trends of corporate wage and dividend payments have diverged sharply this year. In the first eight months, employment in all manufacturing industries, according to statistics of the U. S. Department of Labor, increased 11 per cent over last year, while total payrolls increased 36 per cent. Of 514 industrial common stocks listed on the New York Stock Exchange, 389 paid some dividends in the first nine months of this year as compared with 378 last year, but the number of rate reductions and omissions outnumbered the increases, and the aggregate dollar total of payments declined by 13 per cent. Average annual rate of industrial common stock dividends, as computed in Moody's index, has declined from \$2.09 per share at the beginning of this year to \$1.70 on September 30, and is now slightly below the level of June 1940 when the expanded national defense program was started.

Money and Banking

The revelation by the Treasury that its offering of \$4 billions of notes and bonds in October had been oversubscribed by a bare

\$100 millions has raised some fundamental questions of financing policy. The offering consisted of $1\frac{1}{2}$ per cent notes due December 15, 1946, and 2 per cent bonds of March 1950-52, in proportionate amounts to be determined by the market, upon which subscriptions and allotments totalled approximately \$2,140 millions in the case of the notes and \$1,961 millions in the case of the bonds. This narrow margin by which the total offering was oversubscribed contrasts to oversubscriptions ranging 30 to 50 per cent or more on previous issues for some years past.

The reception accorded the new offering was unusual both for the small oversubscription and for the character of the placement. According to Treasury statement, approximately 75 per cent was taken by the commercial banks. This, as the Treasury frankly acknowledged, was disappointing, as a prime objective of anti-inflation financing is that a much larger proportion be subscribed by the general public.

Moreover, not only were the results disappointing as to response from investors other than commercial banks, but also as to distribution within the commercial banking system itself. While the Treasury has not given out full details of this distribution, 60 per cent of subscriptions from all sources came from the New York and Chicago Federal Reserve districts, though these districts represent less than half the total bank deposits of the country. In the cities of New York and Chicago alone, reporting member bank holdings of Treasury notes and bonds increased by more than a billion dollars during the week of the Treasury allotments; and this, of course, does not include an increase of over \$400 millions in Treasury note and bond holdings by the Federal Reserve Banks in the same period, most of which undoubtedly was purchased in the New York and Chicago markets.

In other words, there was not only a heavy concentration of the new issues in the banking system, but also in the banks of the larger cities, particularly New York and Chicago.

Objectives of a Sound Borrowing Program

The outcome of the new financing is thus at variance with what are generally recognized to be the objectives of a sound borrowing program, nowhere stated more effectively than on numerous occasions by representatives of the Treasury. Only within the past month the Hon. Daniel W. Bell, Under Secretary of the Treasury, in an address before the Investment Bankers Association said:

I have tried to emphasize that it is our firm belief in the Treasury that we should borrow from commercial banks only on a residual basis—that is, to resort to the commercial banks only after every effort has been made to finance the deficit from other sources. We desire—in so far as we are able—neither to create new money nor to activate old money.

Non-inflationary financing requires that we draw in money that would otherwise have been spent in

buying consumers' goods. It is only by drawing in money that would otherwise have been spent in this way that the Government can check whatever tendency to a price rise it may be producing by its own spending program.

Besides the objective of financing as much as possible of the deficit outside the commercial banks, a second generally recognized objective has been to distribute that portion of the debt the banks will have to take as broadly as possible throughout the banking system. The need for this has been made especially urgent by the constant tendency for funds to flow out of the principal money centers and into the munition-making areas.

Because of this movement, banks in the central reserve cities of New York and Chicago have found their reserves steadily drained away, and the Reserve Banks have been under the continuous necessity of replenishing them through open market purchases of government securities and successive reductions of the reserve requirements against deposits. As the Federal Reserve Bulletin said in August—"As long as New York City banks are heavy purchasers of government securities funds are likely to flow from that center to the rest of the country. Consequently, unless banks outside New York and Chicago or investors other than banks take increasing proportions of government securities, New York and Chicago banks will need additional reserves if they are to continue to purchase government securities."

Both the Treasury and the Federal Reserve have given recognition in various ways to the need for broadening the distribution of government issues. This has been done by increasing the volume of short-term Treasury paper in the form of bills, certificates, and tax notes available to investors, by permitting short-term rates to work up to more attractive levels, and by the standing offer on the part of the Reserve Banks to take all bills tendered to them at a fixed rate of $\frac{3}{8}$ of 1 per cent, thus rendering such holdings practically the equivalent of cash. Victory Fund committees of leading bankers in the different Federal Reserve districts, organized under the leadership of the presidents of the district Reserve Banks, have worked constantly to distribute government financing as widely as possible.

Thanks to such efforts to broaden the appeal to investors, both in the terms and conditions of financing and in the establishment of closer contacts through local committees, encouraging progress has been made in reaching funds—non-banking as well as banking—out through the country, as the results of successive Treasury flotations plainly show.

Factors Involved in the Latest Financing

Why then the disappointing results of the latest major financing? This question should

be examined frankly, with a view to determining so far as possible what the governing conditions were and of bringing about a clearer understanding of the problem.

There is, of course, not the slightest difference of opinion that all the money the Treasury needs to finance the war *must* be supplied. Bankers along with all patriotic Americans expect and want to do their share. In any program laid down by the Government they can be counted on for full cooperation once their duties and responsibilities are clearly understood.

With respect to the latest financing, the following factors appear to have been influential in the outcome:

1. Huge increases in the volume of Treasury financing have come rather suddenly upon the banks and market, and they have not yet adjusted themselves fully to all the implications, nor has there been complete understanding of the Treasury's program. Addresses, like that by Under Secretary Bell since the issue, referred to previously, have helped to clarify the situation.

2. Leaving the subscription books open only two days gave Victory Fund committees insufficient time to do their work, and was too short for many investors to get in their orders. This was especially true in view of the delay in delivery of the printed circulars, many of which did not reach investors until the day the books closed. Mr. Bell referred to these difficulties, and expressed the view that in the future a longer time for subscriptions would be permitted.

3. There were certain technical considerations. The offering, which was of record size, included bonds in the general maturity range in which three large issues already had been placed this year — \$1 billion of 2s in January, \$1,300 millions in May, \$2,100 millions in July — all of which were available in the market at the time of the new issues at but a small fraction above par. Not only was the new bond put in the general range where there was already some congestion, but the maturity both of the bond and of the note was stretched beyond the range which the market expected and felt would have been a fair yield and maturity relationship. In other words, neither issue was made attractive marketwise.

The Major Consideration

It should be stated that the impression, perhaps created, that there was a controversy between the Treasury and the banks over a differential of $\frac{1}{4}$ of 1 per cent in rate — the banks wanting $2\frac{1}{4}$ per cent and the Treasury 2 per cent — is a mistaken one.

Those who had suggested the $2\frac{1}{4}$ per cent rate had in mind a longer bond that would carry appeal outside the banks and attain a

wide distribution over the country. The necessity for this is emphasized by the tremendous, yet steadily growing, rate of Treasury expenditures, the enormous deficit, and the vast quantity of government securities that the banks are going to have to take under any circumstances.

It is true that, measured by the standards of World War I, we have been doing a good job in financing in a non-inflationary manner the great sums needed. In the greatest spending year of the former war, 1919, we collected in taxes and sales of securities to non-banking holders a sum equivalent to about 27 per cent of the national income. For the fiscal year 1943 the corresponding figure seems likely to be well over a third of the national income. The trouble is that doing as well as in the past war is not doing well enough, because the program is so much bigger.

The question of real importance, therefore, would seem not to be whether on any given issue the Treasury can shave $\frac{1}{4}$ of 1 per cent, but rather whether by paying a higher rate the Treasury can get more anti-inflationary money. The important thing is where the money comes from. It is entirely possible for the financing program to fail, even though every flotation is technically a success. Success or failure will be measured in the long run, not by the rates of interest paid, but by the degree to which the financing can be carried through without expansion of bank credit.

In the years to come, people may not even remember what interest rates were paid; what they will remember is what happened to prices and the cost of living.

Rounding out the October financing, the Treasury late in the month offered \$2 billions of $\frac{7}{8}$ per cent one year certificates of indebtedness, of which \$1½ billion was to pay off certificates maturing November 1. The offering at these terms proved attractive to the market and was well oversubscribed. Despite the short maturity, about a third was taken outside the banks.

Reserve Bank Aid to the Market

Early in the month the Federal Reserve Board made a third reduction in the reserve requirements against net demand deposits of banks in central reserve cities, bringing them down to the level of 20 per cent that applies to banks in the reserve cities. Purchases of government securities by the Reserve Banks, both in support of the market and to replenish excess reserves, amounted to \$875 millions during the month, carrying total holdings of the System to a new high point of \$4,440 millions. In addition, the regional Reserve Banks lowered their discount rates on advances secured by government obligations of one year maturity or less from 1 per cent to $\frac{1}{2}$ per cent, and also lowered rates on certain other classes of discounts and advances.

There has been some intimation that further reductions of reserve requirements are not to be expected soon, and that additional funds needed by the market to carry through government financing will be provided by open market operations and by the use of borrowing facilities now made available on a more liberal basis.

The Revenue Act of 1942

On October 21 the Revenue Act of 1942, the largest tax bill in the nation's history, was signed by the President and became law. For approximately eight months the bill has been before Congress, and its passage late in October reflects the recent tendency for tax legislation to lag further and further into the year, with consequent prolonged uncertainty on the part of taxpayers as to what their tax liabilities are going to be. The long wrangle over who should pay the taxes should be enlightening to those who believe that it makes no difference how high the debt goes so long as "we owe it to ourselves." It takes taxes to pay debts, but apparently the problem of raising the money is not so simple even though we do "pay it to ourselves."

Yield of the new taxes, according to Treasury tax experts, is expected to be \$8½ billions gross and \$6.9 billions net after allowing for post-war rebates. Congressional tax experts place the figures higher, at \$9.7 billions and \$8 billions respectively. Taking the lower figures estimated by the Treasury and adding them to the increased revenue already counted on under the old rates, means a total federal tax bill of over \$25 billions, not counting over \$2 billions of old-age and unemployment insurance taxes not passing through the regular budget. And besides federal taxes, there are, as Senator George pointed out, some \$10 billions of state and municipal taxes.

Where the New Taxes Fall

In seeking new revenue, Congress has relied, as in previous tax measures, mainly upon direct taxes on individuals and corporations. Thus out of the \$8½ billions gross of new taxes estimated by the Treasury, taxes on individual incomes are expected to contribute \$6.1 billions, including \$3 billions of Victory taxes on which allowable post-war rebates are calculated at \$1.1 billion.

Total gross corporate taxes are stepped up \$1.8 billion, with allowable post-war rebates of \$550 millions. Increases in excise taxes are expected to yield \$650 millions.

At the new rates, Treasury estimates indicate that the Government will be collecting a grand total excluding social security of over \$8½ billions in taxes upon corporations and \$11 billions in taxes upon individual incomes, approximately seven and ten times respectively actual collections in 1939 before the out-

break of war. The following table comparing taxes in 1943 with those in 1939 by major tax groups indicates the extent to which direct taxes upon corporations and individual incomes have borne the brunt of the increased tax load thus far.

Principal Sources of U.S. Government Revenue Receipts,
Fiscal Years Ended June 30, 1939 and 1943
(In Millions of Dollars)

	1939	1943-a	% of Total	
			1939	1943
Corporation taxes	\$1,249	\$ 8,624	22.0	32.6
Individual income taxes....	1,062	11,028	18.7	41.7
Estate and gift taxes.....	361	544	6.4	2.1
Excise taxes	1,744	3,889	30.8	14.7
Social security taxes.....	740	1,747	13.1	6.6
Customs	319	297	5.6	1.1
Misc. receipts	193	286	3.4	1.1
Gross receipts	5,668	26,416	100.0	100.0
Less old-age insurance trust fund	503	1,365	8.9	5.2
Net receipts	\$5,165	\$25,051	91.1	94.8

a- Budget estimate of January 1942 totaling \$16,487 millions, plus Treasury estimate of increased yield from Revenue Act of 1942 totalling \$8,564 millions. Congressional estimates have placed the increased yield at \$9,700 millions. Includes tax receipts subject to post-war credit, amounting to \$550 millions for corporations and \$1,132 millions for individuals.

It will be seen that by far the major part of the tax increase to date has been in the form of direct taxes upon the corporations and upon individual incomes. While other groups of taxes, except customs, have risen in dollar amounts, their proportionate shares in total taxes have fallen sharply, with the share of excise taxes decreased from 31 to only 15 per cent. These facts would seem to have an important bearing upon the question of where new taxes should apply, and particularly on the question of levying a general sales tax.

Broadening the Tax Base

On the vitally important matter of broadening the tax base, the new revenue measure goes much further than its predecessors. While raising tax rates in all income groups already paying taxes, the new bill digs deeply down into the level of mass incomes, as necessary both for raising substantial amounts of new revenue and for meeting the inflationary problem of absorbing new purchasing power where it is being mainly created.

This tapping of new income sources is accomplished partly through the lower personal exemptions and credit for dependents, partly through higher normal tax and surtax rates, but mainly through the Victory Tax. Applied at a flat rate of 5 per cent to the gross income in excess of \$624 a year of all persons regardless of marital status or dependents, this tax will be particularly effective in reaching income heretofore largely or wholly exempt. Its adoption represents an important step towards seeking revenue where the stream of national income is flowing largest.

Changes in the regular income tax, plus imposition of the Victory Tax, are expected to increase the number of taxpayers to more than 40,000,000, compared with about 20,000,000 paying taxes this year, and only 4,000,000 in 1939. The following table, comparing the new taxes with those in effect in 1939, illustrates how the successive defense and war tax measures have stepped up taxes all along the line, while at the same time extending the range of tax coverage downward into the lower income brackets hitherto untaxed. Figures are given both for a single person and for a family of four.

Comparison of Federal Taxes Payable on 1943 Incomes With Those in Effect in 1939

Gross Income	Single Persons 1939	Single Persons 1943	Married—2 Dependents 1939	Married—2 Dependents 1943
\$ 600	—	5	—	9
800	—	46	—	19
1,000	—	89	—	44
1,500	9	197	—	69
2,000	25	305	—	166
2,500	41	413	—	274
3,000	57	527	—	489
4,000	90	769	—	726
5,000	122	1,012	30	963
6,000	170	1,290	62	1,510
8,000	309	1,876	127	2,115
10,000	464	2,525	260	6,123
20,000	1,514	6,760	1,195	11,501
30,000	3,224	12,270	2,741	23,949
50,000	7,784	24,830	7,140	60,267
100,000	27,494	61,320	26,229	89,441
500,000	269,224	395,585	267,568	810,000
1,000,000	604,184	810,000	602,436	

Total tax given includes normal tax, surtax and (for 1943) the new "Victory Tax". Examples assume that all income is "earned income" and that allowable deductions amount to 10 per cent, and make no allowance for state income taxes or for "post-war credit."

The Problem of Additional Revenues

And still the amount of new revenue expected is generally conceded to be inadequate. Even as Congress has debated the tax bill the needs have increased. In the January budget message, the President estimated total expenditures for this fiscal year at \$59 billions. In April the Budget Director lifted the estimated total to \$73 billions. Last month the figures were lifted again, to over \$80 billions. Already Secretary Morgenthau has announced that he intends to ask Congress for an additional \$6 billions of new taxes.

Where are these new taxes to come from?

One thing seems clear: little of this money can come from the higher individual incomes, or from the corporations. With individual normal tax and surtax rates ranging up to 88 per cent for everything above \$200,000, and with executive salaries limited to \$25,000 after federal taxes, insurance, etc., there is not much more in the way of taxes that the "wealthy" can contribute. Likewise, with the corporate normal tax and surtax at 40 per cent and the excess profits tax at 90 per cent, corporate taxes have gone about as high as they can go

without crippling the business and production mechanism of the country.

In short, regardless of theory, there is no longer a choice about looking elsewhere for any substantial amount of new taxes. Inevitably, in any tax program looking mainly to the well-to-do and to business, the time comes when these sources play out and when taxes must be spread over the great body of the people.

There is little doubt where the bulk of the increased income created by war spending is. It is in the greatly expanded industrial payrolls and on the farms. Mostly this represents income falling within a range of \$1,500—\$5,000. Not only are many persons already in these income brackets having their incomes substantially increased, but large numbers of persons are moving up into this group from lower income levels.

Confirmation of this appears in figures presented by the National Bureau of Economic Research, Inc., in its recent study, "Fiscal Planning for Total War," and summarized in the following table:

Consumer Incomes, Fiscal Years Ended June 30, 1941 and 1943 (Billions of Dollars)

Income Group	1941	1943	Net Change
Below \$1,750	\$24.6	\$19.4	— 5.2
\$1,750 — 10,000	43.9	69.3	+ 25.4
Over \$10,000	12.5	20.2	+ 7.8
Total	\$81.0	\$109.0	+ 28.0

Though the Bureau's estimate for consumer income in fiscal 1943 has proved to be too low, the figures are nevertheless significant in showing the extent to which the rise has concentrated in the great group of incomes from \$1,750 to \$10,000. The decline shown in the lowest group is, of course, merely a reflection of the rise of many incomes previously in this group to higher levels. While the range of the Bureau's \$1,750—\$10,000 group is higher than the range of \$1,500—\$5,000 cited above, the Bureau in its report recognizes the largest gains as occurring in the lower part of its classification.

What Kinds of Taxes?

Unless taxes are levied in ways that draw substantially from incomes benefitting chiefly from war spending it is difficult to see how the wanted \$6 billions of new taxes can be raised, or how the inflationary effects of war expenditures can be prevented. The difficulty about levying taxes as heavy as now called for is that, while they may be paid easily by persons enjoying increased incomes, they may cause severe hardship to those whose incomes have not increased, or may even have decreased. This is particularly true in the low income groups.

This dilemma is the basis of the argument for the so-called "excess income tax" which, like the excess profits tax in the case of corporations, would be levied on *increments* of income over some given base. Thus persons having increased income would pay the tax and others whose incomes remained the same or decreased would not pay. Unfortunately, this tax also has important drawbacks; it would be difficult to administer, it would encounter strong opposition politically, and if applied on any large scale might discourage extra work effort.

Probably the most practical answer to the question of finding additional revenue is reliance upon a number of different taxes. No tax is perfect; all have their advantages and disadvantages. Various taxes affect people in different ways. Some taxes hit some people hard and fail to reach other people altogether.

The graduated income tax is an excellent tax for reaching the middle and upper incomes and for taking account of differing ability to pay. Its chief deficiencies lie at the lower end of the income scale, where the difficulties increase with attempts to reach great numbers of small taxpayers. Not only are costs of tax collection high in these brackets, but tax avoidance is large. These deficiencies become particularly serious in times like these when the bulk of increased national income is going to the low brackets.

The gross income tax, applied at a flat rate like the Victory Tax, would be by itself an unfair tax because of its disproportionate weight on the low income groups. Applied in conjunction with the steeply graduated income tax, it is not an unfair tax, but merely a means of spreading the tax burden more effectively among the low income groups. Usually deducted at the source, it has the advantage of relative ease of collection and reduction of tax avoidance. Its disadvantages are (1) its coverage is deficient outside the area of regular payrolls, and (2) it taxes income that would be saved as well as income that would be spent (unless of course some allowance is made for saving, in which case much of the simplicity of the tax is lost).

The general sales tax, like the gross income tax, would be unfair as an only tax, but used along with the graduated income tax is very useful as an instrument for broadening the tax base. The sales tax reaches everyone; for many persons sales and excise taxes are the

only taxes that do. Moreover, the sales tax leaves the taxpayer some choice as to how much he pays; within limits he can spend or not spend. The sales tax automatically taxes spending and exempts saving.

The spending tax proposed by the Treasury has the sound principle of taxing spending and exempting saving. The principal objections to the tax as proposed were first, its complexity, and second, its severity, particularly in the middle and upper incomes where the inflationary danger is least. Indeed, with all spendings above certain minimum exemptions subject to both a flat tax of 10 per cent and graduated surtaxes running up as high as 75 per cent of all expenditures over \$10,000—and the combined tax superimposed upon the graduated incomes tax—it is evident that a great many people in these brackets would have extreme difficulty in meeting so severe a levy. Yet the principle of taxing spending and encouraging saving is one that should be embodied in the tax structure.

Compulsory savings—or "taxes" that are collected currently and returnable to the taxpayer after the war—afford a means of diverting more consumer purchasing power to the Treasury (hence diminishing inflation danger) than might be politically feasible under straight out-and-out taxes. The disadvantage of this fiscal device is that it is not really a tax but a forced loan and hence adds to the problem of post-war debt.

In short, in all of these different taxes there is some element of good and some of bad. Too great dependence upon any one tax means a correspondingly high rate of that tax, with increased danger of imposing insupportable burdens on some groups of people, while letting off others too easily. The use of a combination of different taxes makes it possible to employ each tax moderately, while at the same time spreading the total coverage broadly. This makes it easier for people to make adjustments, distributes the tax load more fairly, and brings in far more revenue than could reliance upon one or two tax favorites.

Finally, a broad objective that needs emphasis is to put the tax system as completely as possible on a pay-as-you-go basis. This is important not only in the fight against inflation, but also in enabling the taxpayer to meet currently the heavy tax obligations now placed upon him.

United States Treasury Officials Have Observed—

"Travelers Checks . . . are the best means of satisfying financial needs while traveling outside the United States at the present time."

TRAVELERS CHECKS



LETTERS OF CREDIT

IT is most important to employ the maximum protection for money carried in traveling. Whether the trip is for business purposes or to finance a holiday after extra work and responsibilities, your funds should be quickly available for emergencies, schedule revisions and accommodations; or to meet war time contingencies. Travelers Checks and Letters of Credit issued by The National City Bank of New York offer the most satisfactory means.

TRAVELERS CHECKS—NCB Travelers Checks insure your funds against loss or theft. Readily cashed by banks—accepted by hotels and transportation lines, as well as by better shops and restaurants. May be used day or night, weekdays, Sundays or holidays. Issued in denominations of \$10—\$20—\$50 and \$100.

LETTERS OF CREDIT—A convenient, effective method of negotiating drafts when traveling. Branches and correspondent banks will promptly honor your drafts drawn under NCB Letters of Credit.



A visit to our nearest branch or any one of the thousands of National City Bank of New York correspondent banks will assure immediate and courteous attention in providing travel funds.

THE NATIONAL CITY BANK OF NEW YORK

Head Office: 55 WALL STREET, NEW YORK

Branches Throughout Latin America—Correspondent Banks Everywhere

Member Federal Deposit Insurance Corporation

BUY WAR SAVINGS BONDS AND STAMPS

T